



REPORT OF THE AUDITOR OF PUBLIC ACCOUNTS
AUDIT EXAMINATION OF THE REVENUE CABINET

**Made as Part of the Statewide Single Audit
of the Commonwealth of Kentucky**

For the Year Ended June 30, 1999

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Executive Summary

Report Of The Auditor Of Public Accounts Audit Examination Of The Revenue Cabinet

Made as Part of the Statewide Single Audit of the Commonwealth of Kentucky For the Year Ended June 30, 1999

BACKGROUND:

The Auditor of Public Accounts performs a statewide single audit of the Commonwealth of Kentucky annually. As part of this, we audit the Kentucky Revenue Cabinet, an organizational unit of the Commonwealth of Kentucky.

RECEIPTS:

The Revenue Cabinet received \$6,970,759,448.52 for the fiscal year ended June 30, 1999 through various tax types. We audit the largest of these revenue programs annually as part of our Statewide Single Audit.

FINDINGS:

Financial Statement Accounts - *Unqualified Opinion*

There were no new audit findings for FY 99. However, problems noted in past audits continue to exist. The Revenue Cabinet reported that the new Kentucky Integrated Tax Entity System (KITES) would correct several deficiencies noted in the past. However, as of June 30, 1999, this system was not in place.

Also, the proposed Modernized Front End (MFE) was to be up and running. MFE should provide the Revenue Cabinet with the means to process returns more completely and do a better job with compliance efforts. The new MFE is expected to clear other deficiencies noted in the past. However, as of June 30, 1999, this project was not in place.

Other deficiencies were due to lack of staff. For example, Motor Fuel Reports are not being cross-checked as required. We noted that there was a \$27 million mistake or potential refund for Motor Fuels. If this internal control feature had been in place and kept up to date, the mistake would have been caught sooner. A Revenue Cabinet employee stated that they do not have the staff to do the cross-check.

Beginning in May 1997, the Revenue Cabinet assessed and converted mainframe applications and corresponding interfaces to a year 2000 compliant format. The Revenue Cabinet participated in a state disaster recovery exercise last fall and all mainframe tax systems were year 2000 compliant by June 30. One deficiency noted that the Revenue Cabinet should have adequate written security policies and procedures identifying management and user responsibilities for system security. Several policies were drafted; however, they were not approved or issued during FY 99.

Physical security at Perimeter Park needs to be strengthened. Progress was made, including installation of additional interior cameras and a badge swipe lock system for doors. However, there are still security issues that need to be addressed.

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Reportable Conditions Relating To Internal Controls And/Or Compliance:

None Noted For The Audit Period Ending June 30, 1999

Other Matters Relating To Internal Controls And/Or Compliance:

None Noted For The Audit Period Ending June 30, 1999

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INTRODUCTION

KENTUCKY REVENUE CABINET
INTRODUCTION
FOR THE YEAR ENDED JUNE 30, 1999

Introduction

The Auditor of Public Accounts, acting as principal auditor in conjunction with various certified public accounting firms, annually performs a statewide single audit of the Commonwealth of Kentucky. This audit allows the Commonwealth to comply with federal audit requirements as set forth in the Single Audit Act of 1984, as amended by Public Law 104-156, and the regulations contained in the U.S. Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Public Law 104-156, referred to as the Single Audit Act Amendments of 1996, is effective for fiscal years beginning after June 30, 1996.

Audit Approach

Our audit was conducted in accordance with generally accepted auditing standards, Government Auditing Standards, the Single Audit Act Amendments of 1996, and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. The scope of the statewide single audit for the year ended June 30, 1999, included:

- An audit of the general-purpose financial statements and required supplementary schedules in accordance with generally accepted government auditing standards;
- An audit of internal control applicable to the Kentucky Revenue Cabinet, to the extent necessary to consider and test the internal accounting and administrative control systems as required by generally accepted government auditing standards, the Single Audit Act Amendments of 1996, and the provisions of OMB Circular A-133.

The Auditor of Public Accounts' office conducted the audit of the internal control, focusing on the following objectives:

- Considering the internal control in order to determine auditing procedures on the general-purpose Financial Statements of the Commonwealth of Kentucky.

**KENTUCKY REVENUE CABINET
INTRODUCTION
FOR THE YEAR ENDED JUNE 30, 1999
(CONTINUED)**

List Of Abbreviations/Acronyms Used In This Report

FY	Fiscal Year
KITES	Kentucky Integrated Tax Entity System
KRC	Kentucky Revenue Cabinet
KRS	Kentucky Revised Statutes
NA	Not Applicable
CFDA	Catalog of Federal Domestic Assistance
REV	Revenue Cabinet
OMB	Office of Management and Budget

REPORT ON COMPLIANCE AND ON INTERNAL CONTROL



Edward B. Hatchett, Jr. Auditor of Public Accounts

To the People of Kentucky
Honorable Paul E. Patton, Governor
Mike Haydon, Secretary
Kentucky Revenue Cabinet

Report On Compliance And On Internal Control Over Financial Reporting Based On An Audit Of General-Purpose Financial Statements Performed In Accordance With Government Auditing Standards

As part of the audit of the general-purpose financial statements of the Commonwealth of Kentucky as of and for the year ended June 30, 1999, we have audited receipts, refunds, account receivables, and contingent liabilities of the Kentucky Revenue Cabinet, an organizational unit of the Commonwealth of Kentucky as defined by KRS 12.010, and have issued our report thereon dated December 30, 1999. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Commonwealth of Kentucky's financial statements are free of material misstatement, we performed tests of Kentucky Revenue Cabinet's compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Kentucky Revenue Cabinet's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level, the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to management of the Kentucky Revenue Cabinet.

To the People of Kentucky
Honorable Paul E. Patton, Governor
Mike Haydon, Secretary
Kentucky Revenue Cabinet
Report On Compliance And On Internal Control Over
Financial Reporting Based On An Audit Of General-Purpose
Financial Statements Performed In Accordance With Government Auditing Standards
(Continued)

This report is intended solely for the information and use of management and applicable federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report, upon release by the Auditor of Public Accounts, is a matter of public record and its distribution is not limited.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Ed Hatchett", with a long horizontal flourish extending to the right.

Edward B. Hatchett, Jr.
Auditor of Public Accounts

Audit fieldwork completed –
December 22, 1999

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

KENTUCKY REVENUE CABINET
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 1999

SECTION 1 - SUMMARY OF AUDITOR'S RESULTS

Financial Statement Accounts And Schedule Of Expenditures Of Federal Awards

Financial Statement Accounts: We issued an unqualified opinion on the Commonwealth of Kentucky's general-purpose financial statements, which include the Revenue Cabinet, as of and for the fiscal year ended June 30, 1999.

Schedule of Expenditures of Federal Awards: This section is not applicable to the Revenue Cabinet.

Internal Control Over Financial Reporting: Our consideration of the Revenue Cabinet's internal control over financial reporting disclosed no reportable conditions.

Compliance: In relation to the audit of the Revenue Cabinet's accounts that we audited, the results of our tests disclosed no instances of noncompliance that are required to be reported under generally accepted government auditing standards.

Federal Awards

This section is not applicable to the Revenue Cabinet.

Identification Of Major Program Audited

This section is not applicable to the Revenue Cabinet.

Dollar Threshold Used To Distinguish Between Type A And Type B Programs:

This section is not applicable to the Revenue Cabinet.

Auditee Qualified As Low-Risk Auditee?

The Commonwealth did not qualify as a low-risk auditee.

SECTION 2 - FINANCIAL STATEMENT FINDINGS AND QUESTIONED COSTS

There were no new audit findings for the Revenue Cabinet.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

There were no federal award audit findings for the Revenue Cabinet.

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SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

**Kentucky Revenue Cabinet
Summary Schedule of Prior Audit Findings
For the Year Ended June 30, 1999**

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<u>Material Weaknesses</u>					
<i>(1) Audit findings that have been fully corrected:</i>					
1996	97-REV-26	The Revenue Cabinet Needs to Improve Tracking Procedures For Contingent Liabilities	N/A	0	The Status of Pending Cases Report has been combined with the Assignment sheet. This report contains all information needed to better track contingent liabilities.
<i>(2) Audit findings not corrected or partially corrected:</i>					
1995	97-REV-24	The Revenue Cabinet Should Utilize The Automatic Log-off Feature For Information Management Systems And Customer Information Control System Applications	N/A	0	The agency drafted a password protected screen saver use policy during FY 99. The comment has been downgraded to an "Other Matters" issue.
1996	97-REV-25	The Revenue Cabinet Computer System Must Be Modified in Order to Process Year 2000 Data	N/A	0	The agency has completed compliance conversion and testing. The comment was downgraded to a verbal comment.
<i>(3) Corrective action taken is significantly different from corrective action previously reported:</i>					
N/A					
<i>(4) Audit finding is no longer valid:</i>					
N/A					

**Kentucky Revenue Cabinet
Summary Schedule of Prior Audit Findings
For the Year Ended June 30, 1999**

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<u>Other Matters</u>					
<i>(1) Audit findings that have been fully corrected:</i>					
N/A					
<i>(2) Audit findings not corrected or partially corrected:</i>					
1996	KRC – 8	The Revenue Cabinet Should Have Procedures To Document Refund Requests As They Come Into The Revenue Cabinet	N/A	0	KRC has established a Standard Procedure for tracking all refund requests. The proposed Kentucky Integrated Tax Entity System (KITES) will provide KRC with the capabilities to track contingent liabilities more efficiently. However, for the year ended June 30, 1999 this was not fully implemented.
1998	KRC – 1	The Revenue Cabinet Should Properly Safeguard Returns	N/A	0	KRC has appropriate procedures in place to make sure that the type of errors discovered by the auditor do not occur and will provide refresher training for its staff and management in an attempt to avoid these errors in the future.
1998	KRC-3	The Revenue Cabinet Should Ensure That Motor Fuel Reports Are Cross-Checked as Required	N/A	0	At this time, KRC does not have additional resources to assign to this task. The Motor Fuels Tax Section currently employs three field auditors. Returns that are assigned for field audit will be cross-checked in the audit process.
1996	KRC-11	The Revenue Cabinet Should Have Adequate Written Security Policies and Procedures Identifying Management And User Responsibilities For System Security	N/A	0	Several policies were drafted; however, they were not approved or issued during FY 99.

**Kentucky Revenue Cabinet
Summary Schedule of Prior Audit Findings
For the Year Ended June 30, 1999**

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<u>Other Matters (Continued)</u>					
1996	KRC-12	The Revenue Cabinet Should Strengthen Physical Security At The Perimeter Park Building	N/A	0	Progress was made, including the installation of additional interior cameras and a badge swipe lock system for doors. However, there are still issues that need to be addressed.
1998	KRC-2	The Revenue Cabinet Data Entry Section Supervisors Should Ensure That All Batches Are Keyed And Verified By Separate Operators	N/A	0	The number of exceptions was down from the previous year and all logs were noted as being complete. The comment was downgraded to a verbal comment.
1997	KRC – 6	The Revenue Cabinet Should Properly Safeguard Motor Fuel and Motor Usage Returns	N/A	0	KRC has appropriate procedures in place to make sure that the type of errors discovered by the auditor do not occur and will provide refresher training for its staff and management in an attempt to avoid these errors in the future.
1997	KRC – 7	The Revenue Cabinet Should Properly Safeguard Corporation Tax Returns	N/A	0	Area was not significant to the general-purpose financial statements for the year ended June 30, 1999.

(3) Corrective action taken is significantly different from corrective action previously reported:

N/A

(4) Audit finding is no longer valid:

N/A